



INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
400 ARMY NAVY DRIVE  
ARLINGTON, VIRGINIA 22202

REPORT  
NO. 92-081

April 21, 1992

MEMORANDUM FOR ASSISTANT SECRETARY OF DEFENSE (PRODUCTION  
AND LOGISTICS)  
DIRECTOR OF DEFENSE PROCUREMENT  
ASSISTANT SECRETARY OF THE ARMY (FINANCIAL  
MANAGEMENT)  
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL  
MANAGEMENT)  
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL  
MANAGEMENT AND COMPTROLLER)  
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY  
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Final Report on Cost Accounting Standards Coverage for  
Smaller Contractors (Project No. 1CA-0059)

### Introduction

This final report is provided for your information and use. The Contract Management Directorate performed the audit from August through December 1991. The objective of the audit was to determine whether DoD contracting activities were appropriately applying cost accounting standards (CAS) coverage in Federal Acquisition Regulation (FAR) part 30 to smaller contractors. An evaluation was also made of the effectiveness of the DoD internal control procedures for applying CAS coverage. For the purposes of our audit sample, we selected smaller contractors that were not currently identified by contract administration offices as being subject to CAS coverage.

### Survey Results

The DoD contracting officers were appropriately applying CAS coverage in FAR part 30 to smaller contractors. Compliance with CAS coverage was primarily achieved through voluntary disclosures from contractors and reviews of contractor proposals performed by the Defense Contract Audit Agency (DCAA). DoD contract administration offices also ensured that CAS coverage was appropriate by periodically obtaining contractor financial and sales reports. In addition, the DCAA included a separate audit step in its reviews of contractor proposals that determines whether CAS requirements (including submission of a disclosure statement) are applicable.

The audit showed that 25 of the 42 smaller DoD contractors sampled were exempt from CAS coverage. The other 17 contractors were properly complying with CAS coverage requirements even

though contracting officer records did not identify them as being subject to CAS coverage. The primary reason for exemption was contractors claiming exemption by self-certifying as small business concerns. Qualification as a small business concern is based on standard industrial classification codes and employee or dollar size standards as defined in part 121 of Title 13 of the Code of Federal Regulations. In the absence of a written protest from another offeror, the contracting officer may accept the small business self-certification at face value for a particular procurement. We found no instances of contractors incorrectly certifying for the small business concern exemption. Another reason for smaller contractors being exempt from CAS requirements was due to their not meeting CAS monetary thresholds because of price competition, catalog pricing, competitive sealed bids, and contractual awards under \$100,000.

### Scope

The audit included a judgmental sample of 42 selected smaller contractors and subcontractors under cognizance of the following offices of the Defense Logistics Agency, Defense Contract Management Command (DCMC):

- o Defense Contract Management Area Operations, Boston, Massachusetts;
- o Defense Contract Management Area Operations, San Bruno, California; and
- o Defense Plant Representative Office, Boeing Defense and Space Group, Kent, Washington.

At each DCMC location we:

- o Reviewed contracting officer summaries of administered contractors for FYs 1990 and 1991 to determine current CAS coverage status.
- o Concentrated on those contractors identified either as not being subject to, or exempt from, CAS reporting requirements.
- o Reviewed contracting officer CAS correspondence files and contractor procurement system review reports from FYs 1986 through 1991 to ascertain that DoD CAS coverage was appropriate, in accordance with FAR part 30 requirements.
- o Interviewed contracting officers and DCAA personnel who monitor CAS to identify smaller contractors that should have been subject to CAS and could have been subject to disclosure statement reporting requirements.

We reviewed information that was based on computer-generated data, such as DCMC contract administration reports, contractor procurement system review status reports, and master contractor file reference listings. Nothing came to our attention as a result of specified procedures that caused us to doubt the acceptability of the computer-generated data. By using other data and information, we concluded that the computer-generated data could be relied on to achieve the audit objectives.

This economy and efficiency audit was conducted in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. Accordingly, we included such tests of internal controls as were considered necessary. The activities and contractors visited or contacted during the survey are listed in Enclosure 1.

### **Internal Controls**

We assessed the effectiveness of the DoD internal controls for the proper inclusion of CAS coverage, including disclosure statement requirements, for eligible smaller contractors. Formal internal controls were not established at the reviewed DoD contracting activities to ensure that eligible smaller contractors were subject to CAS coverage. However, the audit disclosed no specific instances of smaller contractors that should have been subject to CAS coverage, but were not. Also, contract administration and DCAA offices were taking actions to identify contractors for CAS coverage.

The audit disclosed no material internal control weaknesses as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38.

### **Background**

Public Law 91-379, "Cost Accounting Standards," August 15, 1970, requires certain Defense contractors and subcontractors to comply with CAS and to disclose in writing and consistently follow their disclosed cost accounting practices. Negotiated contracts not exempt in accordance with FAR section 30.201-1(b) shall be subject to CAS. Examples of exempt contracts include awards to small business firms, competitive awards, and contractual awards under \$100,000. The CAS Board is proposing to increase the dollar threshold for determining CAS coverage from \$10 million to \$20 million or more in national defense CAS-covered contract awards. This proposed change will also be used in determining whether a contractor CAS disclosure statement is required.

Contracting officers are responsible for inserting clauses in solicitations for Defense contracts that should be subject to CAS and for ensuring that required disclosure statements are submitted.

### **Prior Audits and Other Reviews**

The DCAA and the Office of the Assistant Inspector General for Auditing, DoD, conduct audits that identify CAS noncompliance issues. However, neither organization has conducted audits to determine the adequacy of DoD controls and administration of CAS coverage for smaller contractors.

The Office of the Assistant Inspector General for Audit Policy and Oversight, DoD, Report No. APO 87-013, "Report on Oversight Review of the Defense Contract Audit Agency's Evaluation of Mobile Contractor's Accounting Systems," September 28, 1987, noted that improvements were needed in DCAA reviews of smaller contractors' accounting systems, including better guidance and more self-initiated audits. DCAA agreed to improve its guidance and perform more self-initiated audits.

Office of the Inspector General, DoD, Report No. 88-079, "Audit of Hotline Allegation of Accounting Abuses," January 27, 1988, showed a potential internal control weakness in the DoD identification of the appropriate coverage for CAS program requirements for certain smaller contractors. A contractor that primarily did subcontract work with the DoD was not identified as subject to full CAS coverage by the contracting officer and DCAA. Contractor assertions on proposals that it had a "monetary exemption" from CAS coverage were not questioned. That contractor, like many other smaller contractors, received only limited audit coverage by DCAA because of the small amount of auditable dollars. The report showed that the contractor was in noncompliance with several cost accounting standards. The cognizant DLA contracting officer fully concurred with the report's findings and recommendations.

### **Report Staffing**

We provided a draft of this report to the addressees on January 24, 1992. Because there were no recommendations, no comments were required of management, and none were received. Any comments on this final report should be provided by May 21, 1992.

We appreciate the courtesies extended to the audit staff. The distribution of this report is listed in Enclosure 2, and the names and titles of audit team members are shown in Enclosure 3. If you have any questions on this audit, please contact

Mr. Richard Jolliffe, Program Director, at (703) 614-6260 (DSN 224-6260) or Mr. Timothy Staehling, Project Manager, at (703) 614-6248 (DSN 224-6248).



Edward R. Jones  
Deputy Assistant Inspector General  
for Auditing

Enclosures

cc:

Secretary of the Army

Secretary of the Navy

Secretary of the Air Force



## ACTIVITIES VISITED OR CONTACTED

### Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Washington, DC  
Assistant Secretary of Defense (Production and Logistics),  
Washington, DC  
Director of Defense Procurement, Washington, DC

### Department of the Army

Assistant Secretary of the Army (Research, Development and  
Acquisition), Washington, DC

### Department of the Navy

Assistant Secretary of the Navy (Research, Development and  
Acquisition), Washington, DC

### Department of the Air Force

Assistant Secretary of the Air Force (Financial Management  
and Comptroller), Washington, DC

### Defense Agencies

Headquarters, Defense Contract Audit Agency, Alexandria, VA  
Branch Office, Boston, MA  
Headquarters, Defense Logistics Agency, Alexandria, VA  
Defense Contract Management Area Operations, Boston, MA  
Defense Contract Management Area Operations, San Bruno, CA  
Defense Plant Representative Office, Boeing Defense and Space  
Group, Kent, WA

### Non-Defense Activities

Office of Management and Budget, Office of Federal Procurement  
Policy, Cost Accounting Standards Board, Washington, DC  
U.S. General Accounting Office, Washington, DC

### Non-Government Activities

Boeing Defense and Space Group, Kent, WA





## REPORT DISTRIBUTION

### Office of the Secretary of Defense

Under Secretary of Defense for Acquisition  
Assistant Secretary of Defense (Production and Logistics)  
Director of Defense Procurement  
Comptroller of the Department of Defense

### Department of the Army

Secretary of the Army  
Assistant Secretary of the Army (Financial Management)  
Auditor General, U.S. Army Audit Agency

### Department of the Navy

Secretary of the Navy  
Assistant Secretary of the Navy (Financial Management)  
Director, Naval Audit Service

### Department of the Air Force

Secretary of the Air Force  
Assistant Secretary of the Air Force (Financial Management  
and Comptroller)  
Auditor General, Air Force Audit Agency

### Defense Agencies

Director, Defense Contract Audit Agency  
Director, Defense Logistics Agency

### Non-DoD

Office of Management and Budget  
Administrator, Office of Federal Procurement Policy  
U.S. General Accounting Office, NSIAD Technical  
Information Center

#### Congressional Committees:

Senate Subcommittee on Defense, Committee on Appropriations  
Senate Committee on Armed Services  
Senate Committee on Governmental Affairs  
Ranking Minority Member, Senate Committee on Armed Services  
House Committee on Appropriations  
House Subcommittee on Defense, Committee on Appropriations  
Ranking Minority Member, House Committee on Appropriations  
House Committee on Armed Services  
House Committee on Government Operations  
House Subcommittee on Legislation and National Security,  
Committee on Government Operations



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